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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Access Charge Reform	)	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

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SUMMARY

Each year, the interstate access charges that long distance carriers pay to incumbent local exchange carriers -- and ultimately that consumers bear -- exceed the costs of providing interstate access by more than $10 billion. By itself, this enormous subsidy warrants immediate and comprehensive access reform. But the social costs of bloated access charges go well beyond this direct harm to consumers. As the Commission recognizes, as long as access charges far exceed cost-based levels, long distance calls that should be made will not be made; bypass that should not occur will occur; and competition that should develop will not emerge. Accordingly, current access rates are "fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create." NPRM ¶ 6.

The solution is as obvious as the problem: the adoption of forward-looking, cost-based rates structured to reflect fundamental principles of cost causation, which alone will provide correct economic signals to the marketplace. The NPRM affirmed that conclusion here, just as the original 1983 order on interstate access rates did in correctly observing that "[i]n an economy increasingly dependent upon information and communications, the dynamic losses caused by investment misdirection can no longer be afforded."

As explained in Section I, this is even more true today than it was then. With the recent long distance entry by GTE and other bottleneck monopolists, the economic case for immediate Commission action to reduce access rates to efficient levels could not be clearer. Indeed, because an incumbent's transport and termination of local traffic involves the same network functions as transport and termination of traffic from distant exchanges, the *Local*

Competition Order establishes both the legal necessity and the practical need for immediately driving access rates toward more efficient levels. In particular, the Commission's determination that unbundled network element prices must reflect forward-looking costs in order to be just and reasonable demonstrates that current *access* rate elements, which are many times those of their network element twins, are unjust and unreasonable under Section 201. That determination also demonstrates that existing access rates are patently discriminatory (thus contravening Section 202), as well as violative of Sections 251 and 252 of the 1996 Act, which require interconnection at cost-based rates for the provision of any telecommunications service.

In these circumstances, as explained in Section II, it would be arbitrary *not* to immediately reinitialize access price caps to approximate the forward-looking, cost-based rates that would prevail in a competitive market. This "competitive pricing" approach does not raise serious implementation issues: new price cap levels can be set by targeting only the key access elements that account for the vast majority of access revenues, and then relying heavily on the existing evidence of appropriate price levels established by recent state determinations addressing equivalent network elements. Nor do ILEC claims of potential "underrecovery" provide any legitimate impediment to reinitialization. Certainly, there is no legal barrier to the immediate reduction of exchange access rates to forward-looking, economic cost levels that will not threaten any incumbent's financial viability. Nor is there any policy basis for preferring ILECs and their shareholders over consumers through some "make-whole" scheme. The relevant evidence suggests that no incumbent will be denied an opportunity to recover its prudent investment in network facilities that provide both access and many other services. But even if some isolated underrecovery claim could ultimately be substantiated, the proper remedy is to handle such claims, when and if they arise, through a separate waiver procedure, not to saddle consumers with billions of dollars in excess charges on the basis of mere speculation.

As explained in Section III, the NPRM's alternative "market-based" proposal would do just that. Indeed, the Commission's terminology completely mischaracterizes the approach, which should more properly be deemed a "monopoly pricing" approach because there simply are no market forces to constrain incumbents' access prices. Although competition may ultimately constrain ILEC pricing behavior -- and even this possibility is unproven -- unbundled network element-based competition is in its infancy and will remain so into the foreseeable future. In addition, even when and where it becomes well established, entry through the use of unbundled network elements can only provide indirect and imperfect pressure on access prices. Facilities-based competition at levels sufficient to constrain ILEC prices can be expected, if at all, only after new entrants establish widespread customer relationships, which cannot happen until resale and network element-based competition become well established. Accordingly, leaving price caps at their current inflated levels would virtually guarantee the continuation of inefficient and unlawful access rates, and would thus be arbitrary.

In short, the Commission has its terminology backwards: The "market-based" approach is misnamed because no competitive access "market" yet exists or will emerge if the

Commission adopts that approach. And the "prescriptive" approach is misnamed because it is the *only* mechanism by which to create genuine competition and true "market-based" rates.

Regardless which approach the Commission adopts, however, certain aspects of the current access regime require immediate revision. For example, as explained in Section IV, the Commission's Part 69 rate structure rules should be modified in several respects to reflect well established cost-causation principles. The Commission should start by eliminating the carrier common line charge and allowing nontraffic-sensitive costs associated with each subscriber's local loop (and line card) to be fully recovered from that subscriber. All consumers will plainly benefit from this change because, although they may pay somewhat higher subscriber line charges, any such increase will be more than offset by massive rate reductions resulting both from reduced access charges and from enhanced competition.

Cost causation principles also require a combination of flat-rate and usage-sensitive charges for local switching because a significant portion of switch costs also do not vary with the amount of usage. Other obvious reforms include elimination of the transport interconnection charge and implementation of the Commission's proposed unbundled rate structure for SS7 signaling. Finally, to prevent future abuses, the Commission should limit CLECs' carrier terminating access charges to ILEC rate levels, absent specific cost support for higher rates.

In addition, as explained in Section V, certain modifications to the Part 61 price cap rules are required. Most notably, the Commission must remove all express subsidies, particularly universal service-related payments, from the price caps. In addition, the

Commission should remove certain implicit cross-subsidies, including retail, billing and collection, and equal access conversion expenses, all of which are currently reflected in carrier access charges. The productivity offset or "X-Factor" must also be increased to ensure that price caps do not improperly rise relative to inflation and industry productivity gains, and that incumbents do not further increase their ability to engage in anticompetitive conduct, thwart entry, and impose excessive costs on consumers. And, as explained in Section VI, once access is priced at forward-looking economic cost and efficient rate structures are in place, the Commission should eliminate the enhanced service provider exemption.

Finally, as explained in Section VII, the Commission should grant ILECs only limited pricing flexibility prior to the actual emergence of substantial competition. Although the 1996 Act has brought new opportunities for local exchange and access competition, these markets cannot instantly be transformed into competitive ones. The pricing flexibility "triggers" proposed in the NPRM, moreover, do not remotely reflect the kind of competition needed to constrain ILEC prices. For that reason, the flexibility measures proposed in the NPRM -- i.e., to allow further geographic deaveraging, additional volume and term discounts, contract tariffs, deregulation of new service offerings, the elimination of service categories within baskets, the combination of the traffic-sensitive and trunking baskets, and differential pricing across customer classes -- all threaten to increase customer rates, particularly in rural areas, and allow incumbent monopolists to cross-subsidize competitive services and markets.

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COMMENTS OF AT&T CORP.

Pursuant to the Commission's Notice of Proposed Rulemaking,[1] AT&T Corp. ("AT&T") hereby submits its comments with respect to the designated issues concerning interstate access charges paid to incumbent local exchange carriers ("ILECs").

INTRODUCTORY STATEMENT

As the Commission recently noted, "[t]he fundamental objective of the 1996 Act is to bring to consumers of telecommunications services in all markets the full benefits of vigorous

[1] Access Charge Reform, CC Docket No.96-262, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, (released Dec. 24, 1996) ("NPRM").

competition."[2] Because competition promises unprecedented consumer benefits, Congress directed the Commission and state regulators to act with unprecedented speed to achieve the Act's objective.[3]

The key to a rapid shift to this new regime is "the opening of one of the last monopoly bottleneck strongholds in telecommunications -- the local exchange and exchange access markets -- to competition."[4] As the Commission determined in its landmark *Local Competition Order*, the means to that end is economically efficient pricing of the monopoly inputs that competitive carriers need in order to introduce competition in local exchange and exchange access markets.[5] Until those inputs, including the unbundled network elements addressed in the *Local Competition Order* and the access elements at issue in this proceeding, are available at efficient prices, ILEC monopolies will remain unchecked.

If it can be accomplished, breaking these entrenched monopolies and developing competition could justify relaxed regulatory oversight of access charges and reliance on

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[2] Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking ¶ 7 (release Dec. 24, 1996) ("*Non-Accounting Safeguards Order*").

[3] See, e.g., 47 U.S.C. § 251(d)(1); id. § 252(e)(4); H.R. Rep. No. 104-204 at 89 (1995) (Act designed "to shift monopoly [local telephone] markets to competition as quickly as possible").

[4] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd. 15499 ¶ 4 (1996) ("*Local Competition Order*").

[5] *Local Competition Order* ¶ 672 ("We believe that the prices that potential entrants pay for these elements should reflect forward-looking economic costs in order to encourage efficient levels of investment and entry").

market forces to discipline the ILECs. But this will take time, even after essential inputs are available at efficient prices, and even if genuine exchange access competition is possible. If, when, and under what conditions that level of exchange access competition will develop are difficult questions that should be addressed in a future proceeding.

However, concerns about those issues need not and should not prevent the Commission from moving quickly to reform the existing system of access charges. Any delay in the creation of efficiently-priced access inputs inevitably means delay in bringing the full benefits of the Act to consumers. The price of any such delay is enormous -- more than $10 billion each year in direct foregone consumer benefits resulting from inflated access charges that, as Section I shows, are not only anticompetitive, but unlawful as well. And the total social costs of this inefficient system are far greater than this number alone suggests, and may be as high as $45 billion per year.[6] As the Commission recognizes in the NPRM (¶ 7), the current access charge system not only "inflate[s] usage charges," but also requires incumbent LECs to "maintain rate structures that have been widely criticized as economically inefficient." These structures require that LECs "in essence overcharge high-volume end users in order to reduce rates for low-volume end users." Id. In so doing, these rules create "uneconomic bypass . . . inefficient entry . . ." and may preclude "efficient entry by an otherwise efficient provider." Id. ¶ 42. These rules also "keep long distance rates higher than they would otherwise be" and thereby "restrict demand" for long distance services. Id. Perhaps most important in today's

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[6] Robert Crandall and Jerry Ellig, Economic Deregulation and Customer Choice: Lessons for the Electric Industry, Center For Market Processes, George Mason University (January 1997) ("Economic Deregulation and Customer Choice").

regulatory environment, the existing access rules threaten competition in long distance markets by creating the possibility of anticompetitive pricing conduct by ILECs who also provide long distance services. Id. For all these reasons, the access charge system must be fundamentally reformed, not at some point in the uncertain future, but *now*.

In this regard, the Commission's recent *Local Competition Order* provides an appropriate model. There, the Commission acted to promote the rapid availability of efficiently-priced network elements in local exchange markets. The Commission did this by directing immediate unbundling and the implementation, by the states, of a forward-looking cost-based pricing.

The Commission must take similar immediate action here for exchange access elements which today far "exceed economically efficient levels." NPRM ¶ 41. Although the interstate access rates of Tier 1 ILECs are constrained by price caps, those caps were "initialized" at embedded "cost " figures using an allocation process that the Commission recognizes is "fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create." Id. ¶ 6.

In this proceeding, the Commission properly seeks through further regulatory reform to produce what "a competitive market for access services would produce." Id. ¶ 13. The NPRM identifies two principal reform alternatives. The first method -- "reinitializing" access price caps using the same rate methodology the Commission adopted for network elements that use the same bottleneck ILEC facilities -- is wrongly labeled as a "prescription" approach. This method, however, is the only approach that will "move [access] prices to cost-based levels quickly" (NPRM ¶ 143), and thus establish true market-based pricing. The other alternative is to maintain price caps at their current inflated levels in hopes that as-yet inchoate market forces, although ineffective at constraining ILEC access prices now, will somehow do so in the future.

But the latter approach -- erroneously denominated as "market-based" -- is so inadequate that it would more accurately be described as a "monopoly pricing" approach. The Commission itself concedes that this approach "may not be sufficient to drive access rates to forward-looking economic costs." Id. ¶ 16. In fact, under this approach, access rates not only would remain inflated (and unlawful) for the foreseeable future, but would cause significantly *more* competitive harm in the future than they have in the past. To allow ILECs to continue to assess billions of dollars in excess charges, when these inflated charges will impede competition in local exchange, exchange access and interexchange markets, would be profoundly harmful to consumers..

First, it is inaccurate to describe the "market-based" approach as consistent with the "pro-competitive, de-regulatory national policy framework" envisioned by Congress.[7] In reality, that approach merely couples a "hands-off" approach to setting maximum prices with a proposal for future price cap flexibility. But the long-term decision of when and how to relax specific pricing restrictions once competitive market forces emerge is wholly independent of the more immediate decision whether to adjust inflated price cap levels to reflect the reality that market forces do not and cannot constrain ILEC access prices today.

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[7] See NPRM ¶ 142; S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. (1996) ("Joint Explanatory Statement").

Neither of the Commission's proposals contemplates immediate deregulation, and either could be accompanied by subsequent price cap deregulatory reforms. Thus, although AT&T strongly supports immediate reinitialization of price caps to efficient levels, it also supports the initiation of a comprehensive rulemaking to establish standards for granting an ILEC expanded pricing flexibility in any particular market -- if and when the ILEC can show that actual competition has created effective price discipline there.

Second, there is no basis for the concern that implementing the reinitialization approach would be administratively burdensome, requiring the Commission "to make detailed determinations of appropriate price levels for multiple services throughout the country." NPRM ¶ 143. Most of the work of determining appropriate price cap levels has already been completed by the Commission and the states in creating the framework for regulating rates for unbundled network elements and the transport and termination of local traffic. As the Commission has recognized, the distinction between interexchange access and transport and termination of local traffic is totally artificial: whether traffic originates locally or from a distant exchange, "transport and termination of traffic by a particular LEC involves the same network functions." NPRM ¶ 9. The Commission has already developed and defined the forward-looking rate methodology that will appropriately compensate ILECs and produce efficient rates for these network functions, and most states have already implemented that methodology in interconnection proceedings to establish rates for network elements.

Third, there is no reason to be concerned that a policy of pushing access price caps to more competitive levels would, for reasons of law or equity, require additional proceedings to determine what portion, if any, of the difference between current and future revenues should be treated as a compensable "underrecovery" by the ILECs. NPRM ¶ 143. Moreover, additional regulatory proceedings (if they were necessary) would be a small price to pay for the tremendous economic and social benefits associated with immediate access reform. Nor should the Commission be overly concerned about confronting these issues head-on, because the ILECs' legal and equitable claims to "make-whole" payments in addition to compensatory access rates are baseless. Under the reinitialization approach outlined below, ILECs would have ample *opportunity* to recover all of their prudent investments. That is all the law requires.

In sum, the Commission has its terminology backwards: The so-called "market-based" approach is not market based because no competitive access "market" yet exists. And the "prescriptive" approach is "market-based" because it represents the only mechanism by which to create genuine competition and insure competitive market-based prices.

In short, there is no credible or lawful justification for continuing to ignore the access problem, under the guise of a "market" solution or otherwise. Price caps should therefore be reinitialized to reflect more competitive rates for key carrier access elements. Section II (and parts of Sections IV and V) explain in detail how this can and should be done. Section III explains in more detail the weaknesses of the "market-based" approach.

Regardless which approach the Commission adopts, however, certain measures can and should be taken immediately, both to minimize competitive distortions, and to reduce the impact on consumers of existing cross-subsidies. First, as Section IV shows, the Commission's

Part 69 rate structures for access charges must be modified so as to be consistent with basic cost-causation principles. Indeed, to comply with the Act's mandate that universal service support subsidies "be explicit," 47 U.S.C. § 254(e), the Commission must remove implicit carrier support subsidies that are currently embedded in access prices by virtue of the Part 69 rules. This would certainly include allowing full recovery of non-traffic sensitive loop costs from the subscriber by eliminating the carrier common line charge and the cap on the subscriber line charge -- changes that would benefit consumers because they would make possible, and be more than compensated by, massive reductions in long-distance rates. The Commission should also modify the rate structure for local switching so as to include port charges and usage-sensitive charges. And the Commission should eliminate the concededly non-cost-based transport interconnection charge or "TIC," which the Commission has already been ordered to reexamine. Finally, the Commission should also adopt the NPRM's proposal for handling SS7 signaling costs, and should take certain steps to ensure that terminating access is priced at efficient levels.

Second, as shown in Section V, certain additional changes must be made to the existing price cap regulatory structure if the Commission is to satisfy its obligation to ensure cost-based access rates. Obviously, if the Commission does not reinitialize all price caps to reflect forward-looking economic costs, all express subsidies -- including amounts received from the new Universal Service Fund -- must be removed from the price caps for access rates. And, even if the Commission properly reinitializes access price caps, the productivity offset or "X-Factor" must be substantially increased from the current minimum of 4.0 percent to at least

8.8 percent (9.8 percent without a sharing adjustment) to ensure that access rates do not rise in relation to inflation and industry-wide productivity growth in the future. This change is independently necessary to ensure that consumers receive the benefits that accompany productivity and efficiency gains, as well as declining and input prices.

Third, as shown in Section VI, once access is priced at forward-looking economic cost, and efficient rate structures are in place, the Commission should eliminate the enhanced service provider exemption. It will have lost whatever justification it may have had in the past.

Finally, as shown in Section VII, regardless what the Commission does about price cap levels, it is critical that price cap baskets, service categories, and other restrictions designed to prevent cross-subsidization, remain firmly in place until price-constraining competition actually emerges in access markets. The 1996 Act did not magically erase ILEC incentives or abilities to cross-subsidize. Only substantial competition can do that. Until such competition develops, the Commission should resist combining baskets, eliminating service categories or rate structures, deregulating services, expanding authority to price discriminate or doing anything else that would make it easier for ILECs to cross-subsidize potentially competitive access elements with monopoly elements. Jumping the deregulatory gun, as the NPRM proposes, would inevitably and directly harm consumers -- primarily low-volume and rural consumers -- by delaying and impeding the competition that will bring them lower prices and increased quality and innovation.

I. ACCESS RATES MUST BE REDUCED TO LONG-RUN INCREMENTAL COSTS TO PROMOTE THE ACT'S FUNDAMENTAL COMPETITIVE OBJECTIVES.

It is beyond dispute that ILECs currently possess substantial monopoly power over the provision of exchange access services. Even where competitive exchange access providers exist -- and they generally exist only in limited quarters of the nation's largest metropolitan areas -- ILECs continue to dominate. Indeed, the Bell Operating Companies ("BOCs") alone "account[] for approximately 99.1 percent of the local service revenues" in "local exchange and exchange access" markets.[8] For this reason, ILEC interstate access charges in all but a few locales are constrained only by regulation.

As a result, and because of the inadequacies of the existing regulatory structure, exchange access prices far exceed efficient levels. As explained in more detail below, excessive access prices produce several perverse effects: they impede the development of competition, provide the wrong investment and use signals, and foster discrimination and other anticompetitive ILEC abuses. The only solution to these problems is immediately to reduce access prices to forward-looking cost-based levels.

A. Existing Regulation Has Produced Exchange Access Prices That Far Exceed Efficient Levels.

Existing regulation is a weak constraint at best. As the NPRM notes, the price caps that limit interstate access charges are relics of "the telecommunications marketplace in 1983" when policy-based "implicit support flows" among regulated services were not only allowed, but encouraged. NPRM ¶ 6. Thus, an ILEC's access price caps reflect, not an effort to

[8] *Non-Accounting Safeguards Order* ¶ 10.

duplicate "the operation of a competitive marketplace" (¶ 23), but "a multi-step" allocation (¶ 22) -- "subject to distortions" (¶ 23) at each step -- of the embedded costs of the ILEC's multi-use local network among myriad regulated and unregulated and intrastate and interstate services and elements (id. ¶ 22).

Those distortions have produced access price "caps" that bear no relation to any measure of the economic cost of providing interstate access. The Commission itself has expressed "uncertainty about the specific sources of the costs" allocated to access (¶ 102), and those "costs" also reflect hidden overearnings, inefficiencies, and overinvestment targeted at non-telephony opportunities. Whatever the precise difference "between current interstate access rates and rates based on forward-looking economic costs" (¶ 239), it cannot be seriously doubted that the former greatly exceed the latter. Indeed, even ILECs "agree that current per-minute interstate access charges exceed economically efficient levels and that, consequently, per-minute interstate access charges must be reduced." Id. ¶ 41.[9] Thus, the Commission is surely right that access price cap constraints, as currently implemented, "are fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create." Id. ¶ 6. For this reason alone, those rates now are also unjust and unreasonable and, therefore, unlawful.

Because access rates far exceed rates determined under the forward-looking methodology that the Commission found just and reasonable for functionally equivalent network elements, current access charges are -- by the Commission's own rationale -- unjust,

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[9] See also NPRM ¶ 219 ("reducing access rates should in most, if not all, cases result in rates that are closer to cost").

unreasonable, and patently discriminatory in violation of sections 201 and 202 of the Communications Act.[10] They also violate section 251(c)(2) of the 1996 Act, which requires ILECs to "provide, for the facilities and equipment of any requesting carrier, interconnection with the local exchange carrier's network . . . for the transmission and routing of telephone exchange service and exchange access" at rates that satisfy the requirements of Section 252.[11] Because IXCs qualify as "requesting telecommunications carriers" for purposes of Section 251(c)(2)'s interconnection requirement (*Local Competition Order* ¶ 190) and ILECs have a duty to provide interconnection for carriers to allow carriers to provide telephone exchange service, exchange access, or both (id. ¶ 184), interexchange access must also be provided at forward-looking economic cost. In short, current inflated access charges are unlawful on multiple grounds, particularly in light of the thirteen year "transition" since the Commission first recognized that forward-looking pricing was appropriate for access.[12]

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[10] Continuing failure to justify cost differences between these elements which use the same facilities in the same manner may constitute "willful blindness" that "fully deserves the label 'arbitrary and capricious.'" MCI v. FCC, 842 F.2d 1296, 1303 (D.C. Cir. 1988) ("However unimpeachable the origins of the SNFAs and the special access charges, and however reasonable they may appear when viewed in isolation from one another, they cannot be sustained under Section 202(a) unless the resulting differences between them, to the extent that they are based on the costs of like facilities, are not unjust or unreasonable in amount").

[11] 47 U.S.C. § 251(c)(2).

[12] See, e.g., CompTel v. FCC, 87 F.2d 522,532 (D.C. Cir. 1996) ("We need not decide, however, the question whether the interim Part 69 Rules were reasonable when adopted in 1992. The interim period has long since expired with no discernible progress by the FCC toward the determination of actual tandem switch costs. We conclude, therefore, that the circumstances that may have justified the Commission's action in 1992 do not justify its continued inaction in 1994, much less in 1996").

The disparity between access charges and long-run incremental costs is both enormous and growing. AT&T estimates that interstate access charges collected annually from interexchange carriers are more than $10.6 billion higher than the actual economic cost of providing access, based on forward-looking economic cost studies. Even under the most generous assumptions, no more than $4.0 billion of this amount is required to subsidize rates for local service in high cost areas, for the purpose of promoting universal service goals.[13] But that subsidy will be removed from access charges and made explicit as part of the Commission's pending reform of the Universal Service Fund. Thus, the entire $10.6 billion represents a pure uneconomic subsidy to monopoly ILECs.

B. Excessive Access Rates Harm Consumers, Impede The Development Of Competition, Send The Wrong Economic Signals, And Foster Discrimination And Other Anticompetitive Practices.

But the mere disparity between access charges and their incremental cost does not begin to capture the total social costs associated with excessive access rates. Those social costs were of staggering proportions even before the passage of the 1996 Act. They are now intolerable. Excessive access rates directly impede Congress' primary objective of rapidly bringing competition to local exchange and exchange access markets by providing ILECs with a significant, unearned competitive advantage over their potential competitors. They also produce a host of equally harmful indirect consequences: they distort carriers' entry decisions and consumers' use decisions; they encourage cross-subsidization of potentially competitive services and elements by monopoly elements; and when ILECs provide long distance services,

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[13] See Letter from R. Gerard Salemme, Vice President, Government Affairs, AT&T, to Regina Keeney, Chief, Common Carrier Bureau, Nov. 22, 1996.

they threaten long distance competition. Because telecommunications services are such a large and critical component of the nation's infrastructure, these distortions cause still further indirect harm in virtually every industry and to virtually every citizen. The resulting damage to consumers and the economy is both massive and irreversible.[14] Indeed, one prominent authority has estimated that consumers stand to gain as much as $45 billion if access charges are reduced to cost.[15]

The most obvious harm caused by excessive access charges is the direct harm they cause consumers by raising their long distance bills. NPRM ¶ 42. Quite simply, billions of dollars in excess access charges mean billions of dollars in excess consumer charges. Indeed, AT&T has already committed to flow through to customers the reductions in access charges sought in this proceeding. Moreover, because excessive access prices inhibit competition in other telecommunications markets as well, consumers' total cost for "telecommunications service will not be as low as it could be if all services were priced at economic levels." Id. ¶ 42.

High access charges also harm consumers by undermining competition. Most directly, excess access rates confer a tremendous strategic advantage, particularly as LECs contemplate entry into long distance services. Given that LECs are both competitors and suppliers of IXCs in certain markets (and of CAPS in many more markets), LECs have the opportunity to 'price

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[14] See generally January 29, 1997 Affidavit of William J. Baumol, Janusz A. Ordover, and Robert D. Willig ¶¶ 10-14 ("Baumol, Ordover, Willig Aff.") (attached hereto as Appendix A).

[15] Economic Deregulation and Customer Choice at p. 25.

squeeze' their competitors by raising prices of bottleneck services and lowering prices in competitive downstream markets.[16] To the extent that access charges exceed economic costs, an ILEC faces a lower cost of providing long distance services than competitors who must pay excessive exchange access charges.[17] For that reason, an ILEC "ha[s] an incentive to discriminate in providing exchange access services and facilities that its affiliate's rivals need to compete in the interLATA telecommunications services . . . markets."[18]

Indeed, one principal reason the Commission instituted price cap regulation was to discourage ILECs from such discrimination "in favor of their own vertically integrated operations."[19] The widespread entry of ILECs into long distance only heightens the need for these safeguards. This need is made even more acute by the Commission's decision in Docket 96-149. There, the Commission concluded that those interexchange carriers that provide long distance service on a stand-alone basis will have to pay access charges, whereas those carriers

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[16] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd. 6786 ¶ 19 (1990).

[17] See Ex Parte Letter from Frederick Warren-Boulton to W. F. Caton, FCC, dated December 2, 1996, in CC Docket No. 96-98 ("Chief Economists' Letter") ("the use of historical or embedded costs could result in two inefficiencies tending to sustain local monopolies, even those with outmoded equipment: First, competing providers might have to pay more than a competitive price for necessary inputs, and second, they might have to pay more than the incumbent local exchange carriers implicitly pay for these same inputs. The point of basing prices on TELRIC is to avoid these harms, and to promote competitive efficiency").

[18] *Non-Accounting Safeguards Order* ¶ 11.

[19] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order ¶ 19; See also Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport,, Report and Order ¶ 71.